2017
2027

FRANCE STRATÉGIE
ÉVALUER. ANTICIPER. DÉBATTRE. PROPOSER.

GROWTH AND INCOME DISTRIBUTION IN FRANCE

OCT. 2016

FRANCE WILL FACE IMPORTANT CHALLENGES WHEN IT GOES TO THE POLLS IN 2017 TO ELECT ITS NEXT PRESIDENT. TO BOTH FOSTER AND INFORM DEBATE AMONG CITIZENS IN THE MONTHS LEADING UP TO THE ELECTIONS, FRANCE STRATÉGIE HAS LAUNCHED ITS "2017/2027" PROJECT. IT AIMS TO ZERO IN ON WHAT IS LIKELY TO SHAPE POLICY OVER THE NEXT DECADE BY PUBLISHING A SERIES OF WORKING PAPERS ON TWELVE ISSUES VITAL TO THE FUTURE OF THE COUNTRY. MEMBERS OF THE PUBLIC WILL BE ABLE TO SUBMIT WRITTEN REACTIONS ONLINE. A DEBATE WITH THE AUTHOR(S) AND OTHER EXPERTS WILL THEN BE ORGANIZED FOR EACH ISSUE ON THE BASIS OF THE WORKING PAPER AND THE SUBMISSIONS.

The text that follows is an English adaptation of the working paper on how France can ensure its economy is stronger in the coming decade, with equitable growth and an efficient social model. You can read the original on the "2017/2027" French-language website here.

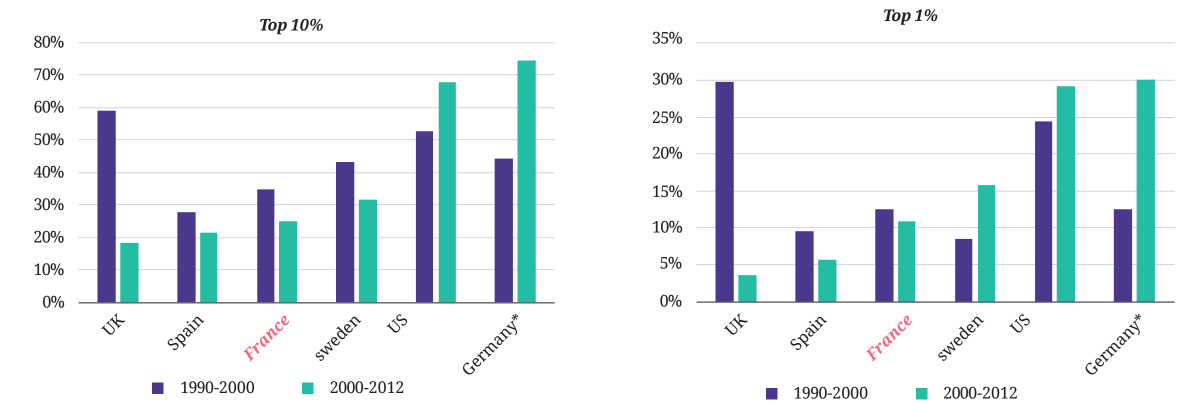
Today, people in France are divided over the benefits of economic growth. While many consider it is a necessary condition for prosperity, there are those who feel it leads to social and regional inequalities, not to mention environmental degradation.

Yet growth provides the additional resources that can be put aside for future spending and the well-being of citizens. It therefore stands to reason that what type of growth should be questioned rather than growth itself. Over the next decade the gains from growth must allow the government to finance investments worth two percentage points of GDP in education, lifelong training and the energy transition.

Even though inequality has progressed in France since the turn of the century, the fruits of growth have been spread more evenly throughout the population than has been the case in other countries since the beginning of the 1980s.

Nevertheless, relatively weak growth and a moderate rise in inequality raise the question of how France's social model can be made more efficient and its economy strengthened. Policies such as improving education and lifelong learning, and reducing discrimination in the workplace can enhance both social cohesion and economic growth. Others such as making use of tax instruments and supporting innovation will require certain trade-offs.

SHARE OF INCOME GROWTH CAPTURED BY TOP 10% AND 1% OF HOUSEHOLDS (BEFORE TAXES AND TRANSFERS)



* The periods covered for Germany are from 1989-2001 and 2001-2010.

SOURCE: France Stratégie, based on the *World Wealth and Income Database*, Paris School of Economics.

THE ARGUMENT FOR GROWTH

TO WHAT END?

Despite an apparent international consensus that growth over the next decade will be weaker than prior to the 2008-09 crisis, opinion on the global outlook is divided. On the one hand, there are those who see the slowdown as a fixture of the foreseeable future. For this school of thought, it is in part related to mounting income distribution inequality, which is compounded by low interest rates, low growth, weak investment and high savings (i.e. secular stagnation). The opposing view holds that the digital economy and technologies yet to be invented will boost productivity and lead to a period of renewed growth.

Above and beyond this is the question of the sustainability of an economic model based on permanent economic growth. The current model of growth is unquestionably responsible for resource depletion, a warming climate and a drastic reduction in biodiversity.

Since the 2009 Stiglitz-Sen-Fitoussi Commission, it is widely recognized that increasing GDP alone cannot be the sole goal of growth. The well-being of the population, the equitable distribution of the fruits of growth and the sustainability of economic development must also be taken into account.

Many countries have since developed indicators to guide government action, even though GDP still weighs heavily in the balance when it comes to deciding policy.

The answer to the question of whether society needs growth should therefore be yes – provided GDP can contribute to enhancing the well-being of the population in a balanced way over the long run.

DOES GROWTH FOSTER WELL-BEING?

It is worth noting there is no automatic link between economic growth and employment. A slowdown in growth as a result of a slowdown in technical progress will have no effect on employment and growth as long as wages and government spending adapt to the lower productivity. Conversely, an increase in productivity gains does not necessarily destroy jobs. It is therefore inaccurate to say that growth above a certain threshold reduces unemployment in the long term. In France, for example, job creation in the medium term has not depended on the rate of growth.

However, it is true that a significant part of French unemployment is cyclical, and for it to be reduced ***in the coming years growth needs to be above the potential that results from an increase in the working population and productivity***. The cyclical unemployment rate is estimated to be between 0.6 and 2.5 percentage points. This means there would have to be additional growth of between 0.1 and 0.3 percentage points per year over the next decade to absorb it.

French citizens remain very attached to the country's social model, which must be financed. A marked slowdown in economic growth would result in social spending as a percentage of GDP increasing. It is therefore crucial to generate the resources necessary over the decade to come to finance the country's social programmes.

The country also needs to invest in the energy transition in order to meet the goal of reducing its carbon emissions by roughly 45% by 2027 to keep global warming within 2°C. Specifically, an estimated €20 billion per year must be invested to meet France's goals set forth in its law on the energy transition and green growth (law no. 2015-992 of August 17, 2015), amounting to close to 1% of GDP per year until 2027.[1]

France must also invest around one percentage point of GDP per year in education to improve outcomes and reduce social and spatial inequalities, in particular at the pre-primary, primary and tertiary levels.[2]

In theory it's possible for a country to devise solutions to confront such challenges without counting on economic growth. For example, it can levy new taxes or social security contributions. However, growth lightens the load the population has to bear and provides a situation that is advantageous to everyone.

What remains to be determined is whether economic growth necessarily increases the well-being of individuals. Economists generally agree that the relationship between the two is positive under certain conditions related to income distribution. Social mobility is also an important factor, as higher income inequality will be better accepted if there is equal opportunity for everyone.

THE RELATIONSHIP BETWEEN GROWTH AND INEQUALITY

Across many advanced economies there has been an increase in wage and income inequality, with growth only benefitting the few. As result it is increasingly questioned as a valid and worthwhile goal.

The question of whether growth is compatible with reducing inequality is one which has been the subject of much debate among economists.[3]

Simon Kuznets theorized in the 1950s and 60s that as a country developed economically inequality would initially increase but subsequently decrease – the famous Kuznets curve.

But the situation today has changed dramatically from the post-war decades. The share of national income going to return on capital in many advanced economies has increased over the past twenty years along with inequality, namely due to a rise in the highest incomes.[4]

Several explanations for the increase in wage inequality in developed countries in recent decades have been put forth. One posits that technical progress has benefitted skilled work, resulting in a polarization of the job market into skilled and unskilled jobs, with decreased demand for work requiring intermediate skills. The argument holds information and communication technologies are causing this polarization to spread across the economy.[5]

Canadian economist Miles Corak's work, which forms the basis for the so-called Great Gatsby curve, has

1. Auverlot D. (2016), "Climate Action: Now or Never", France Stratégie.

2. Agacinski D., M. Harfi and T.L. Son (2016), "*Quelles priorités éducatives*", France Stratégie.

3. The publication of *Capital in the Twenty-First Century* by Thomas Piketty's in 2013 reignited the debate on inequality and growth.

4. Ibid.

5. See, for example, Goos M., A. Manning and A. Salomons (2009), "Job polarization in Europe", American Economic Review, 99(2), May, pp. 58-63; and Harrigan J., A. Reshef and F. Toubal (2016), "The march of the techies: technology, trade and job polarization in France, 1994-2007", NBER working paper series, National Bureau of Economic Research.

shown that as inequality increases in a country, social mobility tends to decrease. Moreover, the OECD recently found that the rise in inequality by more than 2 Gini points on average across 19 OECD countries from 1985 to 2005 is "…estimated to have knocked 4.7 percentage points off cumulative growth between 1990 and 2010."[6] This means less investment in education for lower-income groups, which adversely affects growth, further exacerbating inequality.

Beyond income distribution inequality, there has also been renewed interest in looking at inheritance inequality. Certain studies have found that inheritance inequality weighs on economic growth, namely when capital is acquired through political connections.[7]

In the end, the links between growth and inequality are multiple. ***When inequality has an institutional origin or stems from unearned income, social mobility and growth are both diminished***. The same can be said when it comes to economic rents that aren't the result of individual effort (e.g. certain protected professions, property rents and intellectual property rights protection for established firms to the detriment of new players).[8] On the other hand, inequality can be tolerated when it results from innovation that generates growth and social mobility.

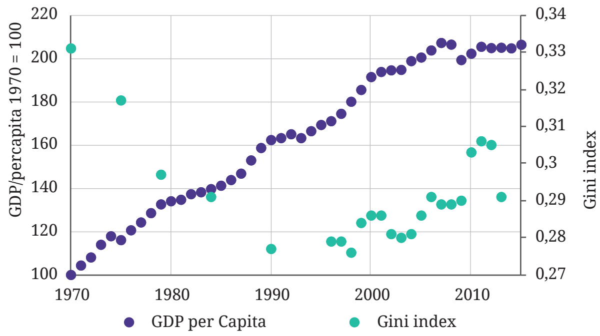
A LOOK AT FRANCE

In France, per capita GDP rose on an almost continuous basis between 1970 and 2007, grinding to a halt in subsequent years. ***Wage inequality, for its part, reached a minimum in the 1990s, but it has increased since the beginning of the 2000s*** (see the Gini index on the graph below). However, it is not possible to rule out a link between growth and inequality based on these observations for the simple reason that institutional changes throughout the period covered may have influenced inequality.

The 2008-09 financial crisis has had a major impact on the past decade: economic growth in France has been significantly weaker than in previous decades, exacerbating a structural slowdown that was already observable prior to the crisis. To be sure, France is not alone among the advanced economies in this, but the gap with Northern Europe has widened. If it continues, its GDP per capita will be 25% less than Germany's in 2027, compared to 15% today.

On the other hand, ***when it comes to income inequality, France has seen less of an increase than in other developed countries***. The share of income growth going to the top households since the beginning of the 1990s is substantially lower than in the US, the UK and Germany. Scandinavian countries are still more egalitarian, but the range of income has widened noticeably (see graph below).

❶ CHANGE IN GDP PER CAPITA AND THE GINI INDEX IN FRANCE SINCE 1970

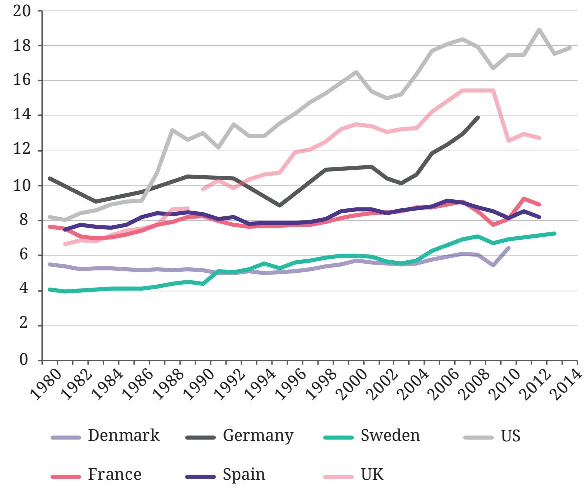


SOURCE: France Stratégie, based on French national statistics office, Insee.

Generally speaking, a relatively high minimum wage in France and less part-time workers have kept inequality in income distribution in check. The flipside is there is much inequality when it comes to employment in the country: some 6 million people would like to work or work more, with unskilled workers hit particularly hard.

In terms of the distribution of wealth, France is around average among OECD countries with respect to the wealth held by the top 10%, 5% and 1% of individuals, well behind the US and Germany, but more unequal than the UK, Finland, Italy and Spain. Indeed, inequality in wealth has increased significantly since the mid-1990s in France. This is largely due to the fact that households that own property have benefitted from soaring real estate values, with prices almost doubling between 1997 and 2008.

❷ SHARE OF INCOME HELD BY TOP 1% BETWEEN1980 AND 2014



CHAMP: Primary household income.

SOURCE: The *World Wealth and Income Database*, Paris School of Economics.

COURSES OF ACTION

What can be done to make France's social model more efficient and its economy stronger given the context of relatively weak growth potential and a moderate increase in inequality? While some policies can achieve both goals, others entail a trade-off.

IMPROVING EDUCATION AND LIFELONG LEARNING

In its 2014 review of France's innovation policy, the OECD highlighted not only the existence of a minority of highly educated specialists or generalists capable of innovating but also a large population of poorly educated individuals not prone to innovation. This reflects the shortcomings of the country's initial and continuing education. Beyond the average academic level of French students when compared to other OECD countries, France suffers from worse than average educational inequalities linked to students' origins and where they live. This adversely impacts

6. OECD (2015), "In It Together: Why Less Inequality Benefits All", chapter 2, May.

7. Bagchi S. and J. Svejnar (2013), "Does Wealth Inequality Matter for Growth? The Effect of Billionaire Wealth, Income Distribution, and Poverty", Discussion Paper series, IZA DP no.7733, November.

8. Galbraith J.K. (2012), *Inequality and Instability. A Study of the World Economy Just Before the Crisis*, Oxford University Press; Stiglitz J. E. (2012), *The Price of Inequality. How Today's Divided Society Endangers Our Future*, Norton & Company.

Adapted by Richard Venturi, based on "*Croissance et répartition des revenus*" by Christel Gilles Boris Le Hir David Marguerit

How can more be invested in education? How can the links between social origins and educational attainment be attenuated? How can on-the-job training be made accessible to all? How can France foster and implement programmes for lifelong learning?

IMPROVING SOCIAL MOBILITY AND REDUCING DISCRIMINATION

Social mobility remains low in France. According to the national statistics office, Insee, the children of professionals (*cadres*) have a 50% chance of becoming professionals themselves, whereas workers' children only have a 10% chance. ***Making opportunity more equal will unleash substantial growth potential and reduce inequalities.***

As mentioned above, inequality in France when it comes to the workplace is high. Whether it affects women or the children of immigrants, it has an impact on the country's overall production. Providing equitable access to the job market and fair employment conditions (e.g. wages and working hours) will boost growth, and it could also reduce upward pressure on high wages. According to a recent France Stratégie study[9], fighting discrimination could add 0.35 percentage points to the country's GDP per year over 20 years.

9. Bon-Maury G. et al. (2016), *Le coût économique des discriminations*, France Stratégie.

What policies can the government pursue to increase social mobility? What can be done to stamp out workplace discrimination? How can female participation in the job market be increased, including for full-time work, while maintaining a work-life balance? More generally, how can structural employment be reined in?

TAX POLICY GOALS

Given France's high tax rates, there is an argument against using taxation as a means to reduce income inequality as it stifles innovation, discourages entrepreneurship and hampers the country's growth capabilities. This school of thought also holds estate taxes discourage investment. On the other hand, the opposing view maintains still more can be done in terms of redistributive policies. Moreover, it asserts that estate taxes promote fairness by diminishing the influence of inherited wealth in determining an individual's destiny.

Should taxation be made more progressive? If so how? Can this be achieved without increasing marginal tax rates? How can capital be taxed to foster its efficient use in the economy and improve fairness? Should inheritances and donations be taxed more heavily?

THE ROLE OF PUBLIC SERVICES

Transport, healthcare and even access to ICTs all contribute to providing citizens with equal opportunities and boosting the economy. Which public services play a central role in reducing inequalities and spurring growth? And which ones must be enhanced?

FOSTERING INNOVATION

While innovation can increase inequality, it can also promote fairness by growing the economy and rewarding individual talent and effort. Though the different public bodies that support innovation have doubled over the past fifteen years, France hasn't met its goal of investing 3% of GDP in R&D. Apart from the complexity of the current system backing innovation, it may very well be keeping underperforming firms in business and preventing an efficient allocation of resources in the economy.

Private financing of innovation has also encountered problems. Though venture capital is above the European average, France still lags far behind Finland, Sweden and the UK. Moreover, there is more French venture capital invested abroad than foreign venture capital invested in French projects.

How can innovation be improved in France? Is the state too present? Does current legislation and taxation pose a problem? How can venture capital be fostered and made more international? Should risk-taking be rewarded through tax incentives even if it increases wage gaps?

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